

July 27, 1999

VIA AIRBORNE EXPRESS

Ms. Donna Caton, Chief Clerk
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, Illinois 62794-9280

Re: Docket No. 98-0866

Dear Ms. Caton:

Enclosed for filing, please find the original and fourteen (14) copies of Sprint Communications Company L.P. d/b/a Sprint Communications L.P.'s Initial Brief concerning the above matter.

Please return one file-stamped copy to me in the enclosed self-addressed stamped envelope. Thank you for your assistance in this matter. Please call me if you have any questions.

Very truly yours,

Kenneth A. Schiffman

KAS:sjw
Enclosure
cc: Service List
(w/enclosure)

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

GTE Corporation)	
Bell Atlantic Corporation)	
)	
Joint Application for Approval of a)	Docket No. 98-0866
Corporate Reorganization Involving a)	
Merger of GTE Corporation and Bell)	
Atlantic Corporation)	

**SPRINT COMMUNICATIONS COMPANY L.P. D/B/A
SPRINT COMMUNICATIONS L.P.'S INITIAL BRIEF**

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Dated: July 27, 1999

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I. SUMMARY OF ARGUMENT

The Commission should reject the proposed merger between GTE Corporation and Bell Atlantic Corporation ¹ because it does not satisfy the relevant Illinois statutory standards. The Commission has stated specific concerns about the competitive effects of the SBC/Ameritech proposed merger.² The same concerns equally should apply here to this proposed merger of huge monopoly providers. The Joint Applicants have not met their burden of proof.³ The merger will have numerous anti-competitive effects in Illinois that are not offset by the efficiencies of the merger claimed by the Joint Applicants.

¹ Collectively referred to herein as either "BA/GTE " or "Joint Applicants"

² Docket No. 98-0555.

³ The Virginia and Kentucky Commissions determined in proceedings that the evidence produced by BA/GTE does not satisfy the standards in those states for merger approval. See Sprint Ex. 1.2. Final Order, State Corporation Commission of Virginia; Case No. PUA980031 (3/3/1/99); Order, Kentucky PSC, Case No. 98-519 (4/14/99).

The merger violates Section 7-204(b)(6) because it has a significant adverse effect on competition in that the merger: (1) eliminates Bell Atlantic as a significant potential competitor in the local exchange market on its own in Illinois; (2) heightens the incentives and ability of the merged entity to discriminate against its competitors in the local exchange market; and (3) adversely effects competition in the intra- and interLATA markets as a result of Joint Applicants' increased incentive to discriminate against rival carriers in favor of its affiliated interexchange carriers.

The primary efficiency of the merger claimed by Joint Applicants, the 21 city strategy, is illusory. Joint Applicants execution of the 21 City strategy will not benefit competition in Illinois. The evidence shows that GTE already had begun competing out of region on its own. Bell Atlantic has the resources and ability to come to Chicago absent the merger and would do so in the near future given its statements regarding the importance of retaining its large corporate customers. Joint Applicants have given precious few details about their 21 City Strategy. For example, when asked how a merged BA/GTE will provide services outside of region, a Bell Atlantic witness responded, "I'm not even certain whether or not there's been a specific game plan. There is not a business case that I have seen developed to any extent for entering those markets."⁴ Suffice it to say that Joint Applicants have not provided any evidence regarding any benefits to be garnered from the out of region entry of the combined company.

⁴ Tr. at 83.

Moreover, the other merger-related efficiencies claimed by Joint Applicants are either non-existent or overstated. Joint Applicants are unable to identify one merger-related best practice that will be imported into Illinois.⁵ Joint Applicants also do not know which corporate entity will provide service outside of Joint Applicants' territory.⁶ After the close of the first round of hearings in the SBC/Ameritech merger case, the Commission indicated that the record there was "appallingly vague."⁷ Here the Joint Applicants too fail to present crucial information for the Commission's consideration.

The reasons for this proposed merger are obvious. Joint Applicants' strategy is to control as many access lines as possible in the United States. The merger gives Joint Applicants a huge competitive advantage in maintaining monopoly power over more than one third of the nation's access lines. The larger monopoly scope gives Joint Applicants a greater ability to discriminate against rivals and to retain larger monopoly profits.⁸ The proposed merger would create a single company controlling more than one third of the entire country's access lines and have more than \$54 billion in operating revenue.⁹

Bell Atlantic could have achieved its goals of increasing size and scope and offering one-stop shopping services to its large corporate customers without merging with GTE. Bell Atlantic simply wants to merge with GTE because it is the least risky way to grow.

⁵ Tr. at 50-52.

⁶ Tr. at 84.

⁷ Docket No. 98-0555, Commission Open Meeting, May 13, 1999.

⁸ Sprint Ex. 1.0, p. 6.

⁹ Sprint Ex. 1.0, p. 7.

Pursuit of less risky strategies as perceived by Bell Atlantic should not govern the Commission's analysis of the proposed merger. The desire to increase size and scale does not require Bell Atlantic to merge with another large ILEC. The advantages of incumbency are too great for Joint Applicants to pass up. It is much easier to obtain customers by merging with another incumbent than to compete for those customers. It is easier to use the advantages of incumbency and repel competition than it is to enter local markets controlled by large incumbents.

Surely, Congress did not have the consolidation of RBOCs and the largest independent ILEC in mind when it passed the 1996 Telecom Act. Surely, the Illinois legislature's pro-competitive directives envisioned large ILECs competing with one another rather than consolidating. Consequently, the Commission must deny the merger. The merger will have a significant adverse effect on competition in Illinois because the alleged efficiencies from the merger do not offset the anti-competitive harms associated with the merger.

II. THE LEGAL AND ANALYTICAL FRAMEWORK

A. Under Illinois Law, The Joint Applicants Must Prove That The Proposed Merger Will Not Have an Adverse Effect on Competition and is in The Public Interest.

Section 7-204(b) of the Illinois Public Utilities Act, provides that "[n]o reorganization [of an Illinois public utility] shall take place without prior Commission

approval.”¹⁰ Under this section, the Commission may not approve a merger or other reorganization unless it finds that all of the following seven factors, which are designed to protect and promote the public interest, have been satisfied.

- (1) the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
- (2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
- (3) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for rate-making purposes;
- (4) the proposed reorganization will not significantly impair the utility’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
- (5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
- (6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
- (7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.”¹¹

Each of the listed factors is designed to ensure that the Commission will not approve a proposed merger or other reorganization unless the transaction will promote the public interest. For example, the first factor, which requires a Commission finding that the merger will not harm the public by negatively impacting the merged entity’s

¹⁰ Illinois Public Utilities Act at § 7-204(b).

ability to provide adequate, reliable, efficient, safe, and least-cost service, is designed to ensure that a broad range of interests important to Illinois residents are considered and satisfied before a merger can be approved.¹²

Likewise, factors (6) and (7) – which require findings that the proposed reorganization is not likely to have a significant adverse effect on competition and is not likely to result in any adverse rate impacts – are consistent with, and are designed to foster, the Illinois General Assembly’s pro-competition policies. The General Assembly expressly has determined that the promotion of competition is in the public interest because “the competitive offering of telecommunications services may create the potential for increased innovation and efficiency in the provision of telecommunication services and reduced prices for consumers. . . .”¹³ In short, by requiring the Commission to consider factors (6) and (7) when evaluating a proposed merger, the General Assembly ensured that the Commission will not approve a merger unless it will promote the public interest in developing competition.¹⁴

¹¹ Illinois Public Utilities Act at § 7-204(b) (emphasis added).

¹² The factors listed in Section 7-204(b) codify the types of factors that regulatory commissions typically have considered when analyzing whether a proposed merger is “in the public interest.” For example, courts and the FCC long have held that the public interest analysis should include factors such as the promotion of competition, diversity, “just, reasonable and affordable rates,” etc. See, e.g., FCC v. RCA Communications, Inc., 346 U.S. 86, 93-95 (1953) (“There can be no doubt that competition is a relevant factor in weighing the public interest”); U.S. v. FCC, 652 F.2d 72, 81-2 (D.C. Cir. 1980) (en banc); In the Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, 12 FCC Rcd. 19985, ¶132 and nn. 67-8 (1997) (“BA/NYNEX Order”); ABC Companies, Inc., 7 FCC 2d 245, 249 (1966).

¹³ Illinois Public Utilities Act, §13-102(f)(emphasis added); see also id. § Section 13-102(e) (“it is in the immediate interest of the People of the State of Illinois . . . to ensure that the economic benefits of competition in all telecommunications service markets are realized as effectively as possible.”).

¹⁴ The General Assembly’s intent that the Commission’s review of mergers be governed by factors that promote the public interest is further seen in Section 7-204(f), which specifically provides that “the Commission may impose such terms, conditions or requirement as, in its judgment, are necessary to protect the interest of the public utility and its customers.”

B. The Commission's Analysis of the Likely Effect of the Proposed Merger on Competition Must Not be Limited to the Application of Antitrust Laws or Antitrust Principles.

The Commission's analysis of the likely effect of the proposed merger on competition is not and should not be limited to the strict application of antitrust laws or principles. The Post Exceptions Proposed Order in the SBC/Ameritech case recognized that the Commission must examine issues other than potential competition such as the market's transition to competition, whether the merger will increase barriers to enter the market, and whether the merger affects the incentives and ability to discriminate against competitors.¹⁵

As the Federal Communications Commission has recognized, a determination that antitrust laws would not be violated by a proposed merger is not dispositive for regulatory agencies, which are charged with the broad responsibility of protecting the public interest. For example, in the Bell Atlantic/NYNEX merger case, the Department of Justice issued a press release stating that the proposed merger did not violate the antitrust laws. Nonetheless, the FCC held that it did "not regard the DOJ action as resolving the issues before the Commission, which involve consideration of the public interest."¹⁶

Although the FCC ultimately approved the BA/NYNEX merger, it did so only after imposing conditions which under a strict analysis of antitrust law, were "unnecessary."

¹⁵ Post Exceptions Proposed Order 98-0555, pp. 60-63. Although Sprint does not agree with the Post Exceptions Proposed Order's analysis and conclusions, the notion of looking at competitive factors other than potential competition should be adopted here.

¹⁶ BA/NYNEX Order at ¶24.

Most importantly, the FCC expressly cautioned that, “[b]ecause we approve the [BA/NYNEX] merger with conditions, thereby reducing the number of independently controlled large incumbent LECs, future applicants bear an additional burden in establishing that a proposed merger will on balance, be pro-competitive. . . .”¹⁷ Here, Bell Atlantic has proposed to purchase another large ILEC, GTE. Bell Atlantic does not satisfy the additional burden suggested by the FCC.

Similarly, the Illinois Commission’s analysis of the impact of the proposed transaction on competition should not consist merely of a determination of whether the proposed merger would violate antitrust laws. As discussed above, Section 7-204(b) is designed to ensure that the Commission will not approve a merger without satisfying itself that the merger will promote a broad range of public interest factors, including the public policy goal of promoting competition. Moreover, nothing in Section 7-204(b)(6) indicates any intent by the Illinois General Assembly to limit the Commission’s investigation of the impact of a proposed merger to a rigid analysis of state or federal antitrust law; indeed, as the FCC recognized in its BA/NYNEX Order, a proper consideration of the public policy goal of promoting competition must be broader than a strict application of antitrust laws.

¹⁷ BA/NYNEX Order at ¶16.

III. THE PROPOSED MERGER WILL HAVE A SIGNIFICANT ADVERSE EFFECT ON COMPETITION

As mentioned, *supra*, Section 7-204(b) provides several factors for the Commission to consider in its review of any proposed reorganization. Included within these factors is an analysis of the effect of the proposed reorganization on competition.

In its testimony, Sprint provides overwhelming evidence that the BA/GTE merger does not comply with these statutory considerations. As summarized in the testimony of Sprint witness Stahly:

I find that the proposed Bell Atlantic/GTE merger will have an adverse affect on competition and may result in the adverse rate impacts on retail customers. My testimony focuses on a comparison of the economic analysis similar to that used by the Department of Justice that formed the basis for the antitrust lawsuit against the vertically integrated AT&T/Bell system in the 1970s. Specifically, the combined Bell Atlantic/GTE entity's control over the major portion of the local network in several states will enable it to damage competition in both the local and long distance markets. Furthermore the proposed merger would eliminate Bell Atlantic as a potential entrant as a local exchange carrier in GTE's service territory. Because of these two factors, the Commission should find that the merger is contrary to the applicable Illinois statutes.¹⁸

A. The Proposed Reorganization Will Have a Significant Adverse Effect on Competition in Those Markets Over which the Commission has Jurisdiction in Violation of 7-204(b)(6).

1. Bell Atlantic is a significant potential competitor in the Illinois local exchange market.

Competition in Illinois will be reduced as a result of the proposed merger. First, Bell Atlantic will be eliminated as a competitor in GTE's local exchange markets.

¹⁸ Sprint Ex. 1.0, p. 4.

Moreover, the merger precludes Bell Atlantic from independently entering local exchange markets outside of GTE's territory, such as the Chicago market. Second, Bell Atlantic is one of a few significant potential competitors in the local exchange markets in Illinois. Third, Bell Atlantic's entry into Illinois likely would deconcentrate the local exchange markets.¹⁹

A strict interpretation of the DOJ merger guidelines would prevent challenge of a merger on potential competition grounds, if there are more than three significant competitors in a particular market. Such an analysis is inapplicable here due to the monopoly characteristics of the local exchange service markets. The FCC in its review of the Bell Atlantic/NYNEX merger cited the authoritative antitrust treatise of Professors Areeda and Hovenkamp, which concludes that the merger of a monopolist (such as GTE) and a "likely entrant" (such as Bell Atlantic) is "presumptively anticompetitive". Specifically, Professors Areeda and Hovenkamp assert:

Merger with a potential competitor acquires special significance when one of the firms is a monopolist. . . . When one of the merging firms is a monopolist and the other is a potential entrant into the same market in which the monopolist has its power, anticompetitive concerns are much more realistic. . . . As a general matter, a monopolist's acquisition of a 'likely' entrant into the market in which monopoly power is held is presumptively anticompetitive. . . . Even if [the potential entrant] seems clearly to be one of several firms which are "equally probable" potential entrants, it is important to preserve all those significant possibilities of eroding the monopoly, and to prevent possible reinforcement of the monopolists' position via the assets acquired.²⁰

¹⁹ This is an adoption (using the facts in this case) of the standard 3 part potential competition test of whether a merger will substantially affect competition in a market. See, Post Exceptions Proposed Order, Docket No. 98-0555, p. 61.

²⁰ BA/NYNEX Order at ¶66 n.155 (quoting Phillip E. Areeda & Herbert Hovenkamp, 3 Antitrust Law (rev. ed. 1996) ¶170d at 134-36).

Due to the monopoly power enjoyed by GTE in its territory,²¹ the merger of GTE and Bell Atlantic is presumptively anticompetitive.

a. Bell Atlantic has the necessary assets to enter Illinois local exchange markets without combining with GTE.

Bell Atlantic amazingly states that it needs to merge with GTE in order to expand into Illinois and provide local exchange service. The numbers and Bell Atlantic's statements prove otherwise. Bell Atlantic has 40 million domestic access lines, 6 million wireless customers and annual operating revenues of \$30 Billion.²² Moreover, Bell Atlantic serves 27.0% of the business lines in the country, more than any other RBOC.²³ It is preposterous to think that a company of this size and strength does not have the assets to enter the competitive local exchange markets in Illinois. If Bell Atlantic cannot be a competitive provider, then the question must be asked of whether any company has the wherewithal to compete. Acknowledging the absurdity of that proposition, Bell Atlantic witness Bellamy in response to a Hearing Examiner question related to Bell Atlantic's resources to enter the Chicago market stated, "I don't think I quite would say it (Bell Atlantic) doesn't have the resources. I think what I'd say is that it would not be a wise use of those resources."²⁴ Undoubtedly, Bell Atlantic has the resources and assets necessary to enter the Illinois local exchange market absent the merger.

²¹ Sprint Ex. 1.1, p. 6. "The number of resold and UNE lines represents less than 1/10 of 1% of all of GTE's lines."

²² Tr. at 77.

²³ AT&T Ex. 1.0, p. 13.

²⁴ Tr. at 86.

b. Bell Atlantic possesses numerous competitive advantages as an Illinois local exchange competitor.

Unlike the small CLECs currently operating in Illinois, the expected entrance of Bell Atlantic would represent an immediate competitive threat to Ameritech and would undoubtedly bring to the Illinois local exchange market the long-awaited benefits of competition. Sprint witness Stahly testified, "So I would certainly anticipate that, but for the merger, that they (Bell Atlantic) would have plans to be making headway into competing in Illinois."²⁵ Mr. Stahly detailed numerous reasons why Bell Atlantic should be considered a potential entrant in Illinois:

First, Bell Atlantic has extensive experience as a supplier of local services, including experience in the engineering, design, marketing and operation of local telephone networks serving all businesses and residences. **Second**, Bell Atlantic possesses fully functioning and time-tested OSS and billing systems that are critically important to the provision of local exchange and exchange access services. The significance of OSS has been most apparent in the Section 271 applications rejected by the FCC. **Third**, Bell Atlantic possesses a clear marketing message based on scores of years of local service provision and a well-known brand name. **Fourth**, Bell Atlantic is likely to be a particularly potent entrant because it has first-hand knowledge of the kind of input provisioning of which an ILEC is capable. If, for example, GTE were to attempt to impede Bell Atlantic's entry by claiming that a service demanded by Bell Atlantic could only be provided in a particularly costly way, Bell Atlantic would be in an excellent position to evaluate the validity of the claim by virtue of its own ILEC experience.²⁶

Moreover, Bell Atlantic is well positioned financially to expand into other service territories. According to Bell Atlantic witness Bellamy, Bell Atlantic is "a very well

²⁵ Tr. at 332.

²⁶ Sprint Ex. 1.0, p. 9 (emphasis added).

capitalized, frankly wealthy company.”²⁷ Ms. Bellamy then explained Bell Atlantic’s desires to be global super carrier.

...We (Bell Atlantic) believe, as many companies believe, there will probably be a small number of . . . global super carriers, and those are companies that will be able to provision a package of services primarily focused at large businesses but eventually focused on all kinds of customers throughout the U.S. and probably internationally, and, frankly, if companies such as ourselves do not actively grow and expand in the manner we’re trying to do by doing this merger, we won’t be one of those global super carriers in the long run, . . . because we want to survive and thrive as a business, we intend to grow so that we can keep up with MCI Worldcom and AT&T and Sprint in being one of those super carriers.²⁸

Despite Bell Atlantic’s self-proclaimed position as a national and global leader in the telecommunications market, its well documented growth strategy which includes global and national ambitions, the myriad of competitive advantages associated with its status as a RBOC, and the attractiveness of capturing revenues of incumbent region business customers from Chicago,²⁹ Bell Atlantic claims that absent the merger, it may not have “branched out of its own regional footprint to any significant degree,”³⁰ and had no plans to enter Chicago.³¹ The Commission should give the self-serving claims of company executives little weight given the abundance of contrary facts. The FCC rejected similar claims from Bell Atlantic when it attempted to make the same arguments to the FCC in connection with the NYNEX merger.

We do not accept Bell Atlantic’s view that the actual potential competition doctrine considers a company’s plans to enter in determining whether it is a market participant only if it is shown that the decision to enter had been made irrevocably and at the company’s highest levels or until the company had committed resources to entry. **The case law under the actual potential competition doctrine does not compel this level of proof. The more authoritative and reasonable case law . . . requires**

²⁷ Tr. at 81.

²⁸ Tr. at 75.

²⁹ Tr. at 81.

³⁰ Tr. at 76.

³¹ Tr. at 79.

only a showing that a company was reasonably likely to enter, not that entry be certain as shown by vote of the Board of Directors or by the commitment of resources.³²

Bell Atlantic has all of the necessary assets and resources to enter Illinois and be deconcentrating force in the market absent the merger.

2. The proposed merger will heighten the incentives and ability of GTE to disadvantage CLECs in the local exchange market.

In addition to the adverse effects on competition associated with the elimination of Bell Atlantic as a significant potential competitor, the proposed merger will also adversely affect competition through the increased anti-competitive incentives the merged entity will have. GTE now has the ability and the incentive to engage in exclusionary behavior against CLECs as evidenced by the actions outlined by Mr. Stahly in his rebuttal testimony.³³ For instance, GTE now refuses to permit Sprint to adopt interconnection agreements in other states unless it agrees to not seek the UNE platform and agrees that GTE does not pay reciprocal compensation for internet traffic.³⁴ Mr. Stahly concludes that the merger will only increase GTE's incentive and ability to discriminate against CLECs.

³² BA/NYNEX Order ¶ 75 (emphasis added) citing, United States v. Falstaff Brewing Corp., 410 U.S. 526, 566 (1973), (Marshall, J., concurring) ("Nor do our prior cases hold that the district courts are bound by subjective statements of company officials that they have no intention of making a de novo entry. We have emphasized that the decision whether the acquiring firm is an actual potential entrant is, in the last analysis, an independent one to be made by the trial court on the basis of all relevant evidence properly weighted according to its credibility.")

³³ Sprint Ex. 1.1, pp. 3-13.

³⁴ Sprint Ex. 1.1, p. 4 and Attachment 1.

a. Current anti-competitive incentives and abilities of Bell Atlantic and GTE.

Currently, due to the still nascent state of local competition, GTE is the only practical supplier of access inputs in its service territory. GTE control 99.4% of the exchange lines in all of its states and 99.99% of the access lines in its franchised territory in Illinois.³⁵ Thus, as the only ubiquitous facilities-based carrier in its region, GTE is effectively able to foreclose price competition in its service territory.³⁶

In addition to its ability to effectively foreclose price competition, GTE is also able to foreclose competition through its ability to deny, delay and degrade the quality of interconnection available to CLECs. Given that GTE still provides service to the vast majority of the customers in its service territory, any alternative provider must interconnect with GTE in order to provide its customers the ability to contact GTE customers.³⁷ As a result of the CLEC's dependency on the GTE system, GTE is able to harm the service provided by the CLEC to its customers by denying, delaying and degrading the quality of the CLEC's interconnection with GTE. "Indeed some competing services may not be offered because entrants cannot attract a sufficient number of subscribers at the price at which it can compete."³⁸ Although many would argue that regulatory commissions have experience in detecting such exercise of market power, the monitoring and determination of allowed behavior is a daunting task.

³⁵ Sprint Ex. 1.0, p. 12.

³⁶ Sprint Ex. 1.0, p. 13.

³⁷ Sprint Ex. 1.0, p. 13.

³⁸ Sprint Ex. 1.0, p. 14.

It “is too optimistic to expect regulation to immediately and completely solve all disputes and prevent all deleterious effects on competitors.”³⁹ The FCC has recognized the incentives and ability of ILECs like GTE to discriminate against CLECs and to frustrate the growth of local competition.

Because an incumbent LEC currently serves virtually all subscribers in its local serving area, an incumbent LEC has little economic incentive to assist new entrants in their efforts to secure a greater share of that market. An incumbent LEC also has the ability to act on its incentive to discourage entry and robust competition by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers.⁴⁰

Consequently, pre-merger GTE has the incentives and ability to hinder the development of local competition in its Illinois service territory.

b. The proposed merger will increase the anti-competitive incentives due to internalization of spillover benefits.

GTE has not opened its local markets to competition. This is troubling since the proposed merger only will serve to increase the incentives of the merged company to engage in even more audacious conduct. The increased incentive for the merged entity to engage in anti-competitive conduct is realized as a result of the internalization of spillover effects.⁴¹

³⁹ Sprint Ex. 1.0, p. 14.

⁴⁰ CC Docket No. 96-98, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order (issued August 8, 1996), Para. 10 (footnote omitted).

⁴¹ Sprint Ex. 1.0, p. 17.

As the market is structured currently, there is no question that GTE benefits when it undertakes activities to exclude CLECs from its local exchange markets. Interestingly, however, GTE is not the only entity that benefits from its exclusionary conduct. When the excluded CLEC operates in multiple markets, the incumbent in each of those markets realizes a “spillover” benefit from GTE’s conduct.

As described in Mr. Stahly’s testimony:

When GTE competitively weakens a rival in Illinois, it may also weaken that rival throughout GTE’s region. While Bell Atlantic may already benefit from GTE’s exclusionary behavior, GTE derives no profits from the benefits to Bell Atlantic. Thus, in deciding the extent to which it will harm CLECs in Illinois, GTE does not take these “spillover” effects on the profits of Bell Atlantic into account.

Following the merger, however, the merged firm would benefit from the effects of its exclusionary activity in Illinois on competition in Bell Atlantic territory. The merged firm, therefore, would incorporate these “spillovers” in choosing the level of effort undertaken to hamper the competitive efforts of CLECs in Illinois. In sum, the merger would make exclusionary behavior in Illinois look more profitable to GTE. And because the gains from exclusion would be “internal” to the combined firm, it would have an incentive to increase the amount of discrimination it undertakes.⁴²

This “spillover” effect will have a huge significant adverse effect on competition. For example, GTE now will consider the effect of not providing the UNE platform in its Illinois territories due its effect on CLECs in other markets. Thus, failure to provide the UNE platform in Illinois harms a CLEC here in Illinois, but that action also may prevent that CLEC from entering the market in Baltimore, Maryland. Similarly refusal to provide collocation space in Illinois to a CLEC may slow entry or reduce the profitability of that CLEC’s market entry in Philadelphia.

Increased exclusionary behavior is likely post-merger by GTE because of the increased rewards. Following the merger, exclusionary conduct, which had once been

so extreme that the realized benefits did not warrant the risk of regulatory sanctions, now becomes a viable alternative due to the internalization of spillover benefits.⁴³ The practical effect is that the merger will lead GTE to search for new methods to exclude competitors and intensify its exclusionary conduct. “As a consequence, local exchange rates would be higher in Illinois, and/or new services would not be as quickly or widely available to Illinois consumers as otherwise would be the case.”⁴⁴

c. The proposed merger will increase the merged entity’s anti-competitive ability through the elimination of a valuable benchmark.

In addition to its inherent ability to increase the incentive of the merged entity to engage in exclusionary conduct, the merger also limits the ability of the various regulatory commissions to detect and prevent such conduct.⁴⁵ Whereas, complainants once had seven RBOCs plus GTE to look towards in assessing the conduct of a certain RBOC, currently there are only six such available comparisons. And if this merger and the SBC/Ameritech merger are approved, the number will be reduced to four. Comparisons have been useful in detecting specific exclusionary conduct on the part of a specific RBOC. For instance, in oral arguments before the Commission on the SBC/Ameritech merger to determine the unreasonableness of Ameritech’s refusal to provide shared transport, several Commission questions were asked as to whether other RBOCs provided shared transport.⁴⁶ The ability to benchmark behavior against other large ILECs is reduced significantly with the consolidation proposed here.

⁴² Sprint Ex. 1.0, p. 17.

⁴³ Sprint Ex. 1.0, p. 18.

⁴⁴ Sprint Ex. 1.0, p. 18.

⁴⁵ Sprint Ex. 1.0, pp. 19-20.

⁴⁶ Case No. 98-0555, Oral Argument April 29, 1999, p. 240; April 30, 1999, p. 339.

Not only will the merged entity have an increased incentive to implement such exclusionary policies, but it will also become more difficult for complainants as well as the various regulatory commissions to judge the unacceptability of such conduct because there will be one fewer “benchmark” by which to compare such conduct. The FCC recognized this phenomenon in its consideration of the Bell Atlantic/NYNEX merger. “A reduction in the number of separately owned firms engaged in similar businesses will likely reduce this Commission’s ability to identify, and therefore to contain, market power.”⁴⁷ Bell Atlantic itself has commented on the importance of retaining benchmarks. “Each BOC services as a benchmark against which the Commissions can measure the performance and behavior of the next; such comparisons were quite impossible before divestiture.”⁴⁸ By reducing the number of available RBOCs and GTE, CLECs “will have a smaller number of ‘checks’ on the reasonableness of any particular ILEC’s response to an interconnection request. Thus, the ability of GTE (and that of all ILECs) to engage in anti-competitive behavior is increased by the merger because the likelihood of detection is reduced.”⁴⁹ As such, if GTE continues to refuse to pay reciprocal compensation under interconnection agreements and Bell Atlantic adopts this position post-merger, this Commission will not be able to compare GTE’s individual behavior to Bell Atlantic’s behavior. The loss of a benchmark makes it more difficult for this Commission to compare the claimed anticompetitive behavior. Clearly, the loss of available benchmark comparisons as a

⁴⁷ Bell Atlantic/NYNEX Order, ¶ 147.

⁴⁸ Bell Atlantic/NYNEX Order, ¶ 149.

⁴⁹ Sprint Ex. 1.0, p. 20.

result of the proposed merger will not only increase the likelihood of exclusionary conduct by the merged entity, but also will decrease the likelihood that this regulatory commission will be able to detect such conduct.

3. The proposed merger will have an adverse effect on competition in the interexchange market.

In addition to the significant adverse effect of the proposed merger on the Illinois local exchange market, the proposed merger also will have an adverse effect on competition in the interexchange market.

Concerns over an RBOC's ability to discriminate in favor of its affiliated interexchange carrier are so real that they formed the basis for the 1984 divestiture of the Bell System. As the evidence indicates, "[t]he divesting of AT&T's local and long distance business was to prevent the combined BOC / AT&T powerhouse from leveraging local access which could have prevented long distance competition from ever fully developing."⁵⁰ Although the Modified Final Judgment's limitation on the BOC's ability to offer interLATA services has allowed competition to fully develop in the long distance market, the proposed merger resulting in a BOC controlling over 35% of the nation's access lines threatens the continued competitive nature of this market.⁵¹ Moreover, this threat will continue so long as the IXCs are dependent solely on this super-BOC for access to customers.

⁵⁰ Sprint Ex. 1.0 , p. 21.

⁵¹ Sprint Ex. 1.0, p. 8.

The interexchange market is similarly threatened as a result of the artificial cost advantage implicit in the merged entity's pricing of access at many times actual cost.

As the Modified Final Judgment noted,

To permit the Operating Companies to compete in this [interexchange] market would be to undermine the very purpose of this proposed decree – to create a truly competitive environment in the telecommunications industry. . . . [T]he Operating Companies would also retain the ability to subsidize their interexchange prices with profits earned from their [access] monopoly.⁵²

Although fifteen years have passed since the Bell System divestiture, the conditions found in today's telecommunications market provide for similar concerns over a BOC's ability to subsidize its interexchange prices. “[A] BOC retains the ability to leverage its huge market size and market concentration in urban areas to subsidize interexchange prices with profits earned from its monopoly [access] services.”⁵³

Utilizing a method known as a “price squeeze,” the merged entity would be able to use the supra-competitive profits associated with its monopoly control of access to undercut the current cost-based prices reflected in the long distance market. Assume the following example, BA/GTE charges IXCs 4¢ per minute for both originating as well as terminating access. Assume further that the network cost to the IXC is 3¢ per minute. Therefore, the marginal cost to the IXC to provide interexchange service is 7¢ per minute (2¢ for origination cost, 2¢ for termination cost, and 3¢ for network cost). As such, for the IXC to charge anything less than 7¢ would involve financial losses.⁵⁴

⁵² Sprint Ex. 1.0 , p. 22 (emphasis added.)

⁵³ Sprint Ex. 1.0, p. 22.

⁵⁴ Sprint Ex. 1.0, p. 25.

Because BA/GTE will only charge its affiliate interexchange provider the actual cost of providing access, approximately 1/2¢ per minute for both originating and terminating access, the BA/GTE affiliate is able to charge as little as 4¢ per minute to its interexchange customers (1/2¢ for origination cost, 1/2¢ for termination cost, and 3¢ for network cost). Given its 3¢ per minute price advantage, BA/GTE's interexchange affiliate is able to either steal customers away from its rival interexchange carriers or, in the alternative, subject the rival carriers to tremendous financial losses.⁵⁵

Moreover, the act of imputing access cost by the merged entity's long distance affiliate is merely a paper transaction which transfers profits from the interexchange affiliate to the local exchange provider.⁵⁶ Effectively, as a result of imputation, the 3¢ per minute price advantage will now be realized by the local exchange provider instead of the affiliate interexchange carrier. GTE witness Attwood testified that he expected the long distance affiliate that is selected to provide service for the combined company to report its earnings on a consolidated basis with the parent company's earnings.⁵⁷ Because the financial results of all the merged entity's subsidiaries are consolidated into a unified financial statement, the profit realized by the corporate shareholders is identical. The only effective difference is that in one instance the profits are funneled through the interexchange carrier, whereas under imputation, the profits are funneled to the consolidated financial statement through the local exchange provider.⁵⁸

⁵⁵ Sprint Ex. 1.0, p. 25.

⁵⁶ Sprint Ex. 1.0, p. 27.

⁵⁷ Tr. at 45.

⁵⁸ Sprint Ex. 1.0, p. 27.

GTE has attempted to use the price squeeze in other forums. Last year, GTE filed a tariff in Missouri for its Extended Reach Plan which was an intraLATA toll calling plan that would compete directly with intraLATA toll calling products offered by interexchange carriers (IXCs) and CLECs. GTE proposed to sell “virtually unlimited”⁵⁹ intraLATA toll calling for 1 ½ cents per minute to residential customers and 3 cents per minute to business customers.⁶⁰ IXCs and facilities-based CLECs pay switched access rates as high as 20 cents per minute to originate and terminate intraLATA traffic and thus, could not match GTE’s 1 ½ cent per minute price. This enormous cost differential would allow GTE’s Extended Reach Plan to significantly harm the development of facilities-based local competition and significantly damage competition in the intraLATA toll market. The Missouri Commission rejected GTE’s Extended Reach Plan because it found that GTE’s toll service was priced below the cost of imputed access charges.⁶¹

Moreover, the proposed merger increases the ability of the combined company to engage in a price squeeze. The merger will increase GTE’s scope significantly and allow it to leverage the subsidies in switched access rates. Mr. Stahly testified as to how the merger facilitates greater leveraging to the competitive disadvantage of the interexchange market.

By itself, GTE has limited ability to leverage its access subsidies to underprice competitors in the interLATA toll market because its properties are scattered across several states and are less concentrated in any one state than an RBOC’s properties. Thus, while GTE can leverage the

⁵⁹ See Direct Testimony of Michael V. Chopp on Behalf of GTE Midwest Incorporated, in docket number TT-98-545, In the Matter of GTE Midwest Incorporated’s Proposed Revision of Its PSC Mo. No. 1 to Introduce LATA-wide GTE the Extended Reach Plan; page 5, lines 14 –16.

⁶⁰ Sprint Ex. 1.1, p. 14.

⁶¹ Sprint Ex. 1.1, p. 14.

access subsidies on the long distance calls that originate with its customers, it usually cannot do so on the terminating end of the call because the vast majority of those calls will terminate to a non-GTE customer. (Note: GTE did this very thing by offering its local customers a 50% discount of their long distance bill for six months if they switched to GTE Long Distance.) However, when GTE combines with Bell Atlantic to capture more than one-third of all access lines in the United States, GTE gains the size and scope necessary to successfully implement a price squeeze. Under this scenario, a significant percentage of interLATA toll calls that originate with GTE's customers will now terminate to a GTE/Bell Atlantic customer. This gives GTE the ability to leverage the switched access subsidies on both ends of the call. Inasmuch as a significantly larger percentage of GTE's dollars for terminating switched access will now be going to itself (via the new GTE/Bell Atlantic entity), GTE has a much greater ability to implement a price squeeze.⁶²

Consequently, the merger gives GTE a greater ability to underprice its long distance competitors because more calls will both originate and terminate in the combined company's territory. This undoubtedly will have a significant adverse effect on competition in the intraLATA and interLATA markets. Competition should be based on better service and technology not on a mega-carrier having an artificial cost advantage over its competitors.

B. The Alleged Benefits of the Merger Are Illusory and do not Offset the Anticompetitive Harms

Joint Applicants claim that the merger will be beneficial for three reasons: 1) the merger promotes competition in the local, long distance and data markets; 2) the merger will generate cost savings; and 3) the merger allows for Joint Applicants to share best practices.⁶³ The Commission should give little weight to Joint Applicant's claims.

⁶² Sprint Ex. 1.1, p. 19.

⁶³ BA/GTE Ex. 1.00, pp. 12-13.

First, as discussed above, the merger removes Bell Atlantic as a significant potential competitor from entering Illinois. Second, GTE through its affiliate GTE CC already is providing local exchange service in Chicago and was intending to compete on a national basis.⁶⁴ GTE's chairman, Charles Lee, stated in GTE's annual report that GTE was preparing to compete as a CLEC on a national basis.⁶⁵ GTE witness Attwood testified that if the merger were not approved, GTE's strategy would be to offer a bundle of services to its customers.⁶⁶ And absent the merger GTE would enter markets outside of its local exchange service territory.⁶⁷ These plans pre-merger announcement were coming to fruition in Chicago. GTE CC today provides resold local exchange service to business customers in Chicago.⁶⁸ In addition, GTE CC provides network integration services and sells customer premise equipment to large business customers in Chicago.⁶⁹ Undoubtedly, absent the merger GTE CC could have provided CLEC services as well to this class of customers. Joint Applicants' claims that the merger will promote competition are wrong. The merger eliminates a competitor, Bell Atlantic, and the merger does not deconcentrate markets-- GTE CC already is a competitor.

Second, the cost savings to be generated by the merger will not be distributed as proposed by Joint Applicants until a rate case is initiated in Phase II of docket

⁶⁴ Sprint Ex. 1.1, p. 20.

⁶⁵ Sprint Ex. 1.1, p. 20.

⁶⁶ Tr. at 53.

⁶⁷ Tr. at 54; Q: Nonetheless though, it would be, absent the merger, a strategy of GTE to enter markets outside of its local exchange service territory? A: Yes, I mean subject to there being a valid business plan and a value proposition that would support entering those markets, correct.

⁶⁸ Tr. at 40.

⁶⁹ Tr. at 41-42. The fact that GTE CC already is in the Chicago market renders meaningless the alleged commitment made by Joint Applicants enter the Chicago market within 18 months after merger approval. BA/GTE Ex. 1.1, p. 14.

No. 98-806, at least two years after the consummation of the merger.⁷⁰ Sprint takes no position on the allocation of cost savings other than the proposal delays any benefits from the merger for at least two years and probably longer given the time it will take for the proposed docket to unfold.

Third, Joint Applicants' explanation that the merger will allow the parties to share best practices is unsubstantiated. The surrebuttal testimony of Mr. Attwood contains a long discussion of best practices and how the merger will facilitate the implementation of best practices.⁷¹ But Mr. Attwood, for example, could not identify at the hearing one interconnection best practice that would be implemented in Illinois as a result of the merger.⁷² The Commission showed great interest in the SBC/AIT merger docket about the importation of interconnection best practices as a result of that merger.⁷³ In response to a letter from the Chairman of the Commission, SBC/AIT made some incomplete commitments riddled with exceptions to import interconnection arrangements from SBC territory to Illinois. Here, Joint Applicants have not even made the incomplete commitments that have been made by SBC/Ameritech. There is no evidence in this record that any competition promoting best practices will be imported to Illinois as a result of this merger.

⁷⁰ BA/GTE Ex. 6.00, p. 9.

⁷¹ BA/GTE Ex. 1.2, pp. 2-10.

⁷² Tr. at 50-52

⁷³ Docket No. 98-0555; June 4, 1999 letter from Chairman Mathias to Hearing Examiners Goldstein and Moran.

Consequently, Joint Applicants have not demonstrated any merger related efficiencies that offset the harms that the merger will bring to competition in the local and toll markets in Illinois.

IV. CONCLUSION

In sum, the anti-competitive risks associated with the merger far outweigh the alleged efficiencies that the merger will bring to Illinois. The merger must be denied because it will have a significant adverse effect on competition in Illinois local and toll markets in violation of Section 7-204(b)(6). The Joint Applicants simply have not met their burden of proof. Erroneous approval of the merger will be a tremendous blow to nascent competition in Illinois. If the merger were consummated, it would for all practical purposes be irreversible. If later, the merger is found to have been anticompetitive, the ICC, other regulatory agencies, and consumers will bear the cost of that mistake on an ongoing basis. The people of Illinois should not bear the costs of an erroneous approval of the merger.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Copies of the foregoing were served on all parties on the attached service list on the 27th day of July, 1999, via overnight mail or U.S. Mail.

Sally J. Werts